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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 1000

RICHARD H. SHAFER AND MARY ANN SHAFER,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented is whether amounts received by taxpayers from the sale of interest coupons detached from Japanese Government bonds were taxable as ordinary income or as capital gain. The bonds, acquired by taxpayers prior to 1942, were originally due to mature in 1953 and 1954, and bore attached semi-annual interest coupons. With the advent of World War II, the Japanese Government suspended service on the bonds. In December 1952, however, it resumed service to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment date prior to September 26, 1952, were extended for a period of ten years from the original payment date (except that in-

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terest due prior to December 1942 was payable on December 22, 1952). The taxpayers agreed to this settlement proposal. The New York Stock Exchange then ruled that blocks of coupons—each consisting of twenty coupons, originally due on dates from 1942 to 1952, but, under the terms of the agreement, due on dates from 1952 to 1962—could be detached from the bonds and sold in transactions apart from the purchase and sale of the bonds themselves. In 1954, taxpayers, through a broker on the New York Stock Exchange, sold coupons bearing restamped due dates subsequent to 1954 (Pet. App. 1a–2a). The district court upheld the Commissioner's determination that the proceeds were ordinary income, and the court of appeals affirmed.

This case is governed by the well-established rule that proceeds from the sale of bond coupons, representing a right to interest which has accrued during the period of the vendor's ownership of the bonds, are taxable as ordinary income.[1] That rule, in turn, is but a special application of the general principle that a taxpayer may not convert ordinary income into capital gain by an anticipatory assignment of the right to that income. See, *e.g.*, *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260; *Hort* v. *Commissioner*, 313

[1] *First Kentucky Co.* v. *Gray*, 309 F. 2d 845 (C.A. 6th); *United States* v. *Langston*, 308 F. 2d 729 (C.A. 5th); *Jaglom* v. *Commissioner*, 303 F. 2d 847 (C.A. 2d); *Fisher* v. *Commissioner*, 209 F. 2d 513 (C.A. 6th), certiorari denied, 347 U.S. 1014. These cases hold that upon the sale of bonds purchased flat (*i.e.*, without allocation of purchase price between principal and interest), the vendor realizes ordinary income to the extent that the sales price is allocable to interest accrued on the bonds subsequent to their acquisition by the vendor.

U.S. 28; *Helvering* v. *Horst*, 311 U.S. 112; *Commissioner* v. *Phillips*, 275 F. 2d 33 (C.A. 4th); *Tunnell* v. *United States*, 259 F. 2d 916 (C.A. 3d); *United States* v. *Snow*, 223 F. 2d 103 (C.A. 9th), certiorari denied, 350 U.S. 831; *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th); *Arnfeld* v. *United States*, 163 F. Supp. 865 (C. Cls.).

To avoid the force of this precept, taxpayers argue that the 1952 settlement agreement with the Japanese Government involved the exchange of the original defaulted coupons for new coupons constituting a new and entirely different security, and that the latter, unlike the former, were capital assets in the taxpayers' hands. This contention was properly rejected by the district court, which ruled, as had the Commissioner in an earlier revenue ruling (Rev. Rul. 54, 1953—1 Cum. Bull. 204), that the acceptance of the offer of settlement and the presentment of the bonds to the Japanese Government for the purpose of overprinting the extended maturity date did not amount to an exchange of property requiring recognition of gain or loss under Section 112 of the 1939 Code. In so holding, the court noted that the sole effect of the settlement was a ten-year extension of the maturity or due dates of the bonds or coupons, and that the terms of the obligation were not otherwise altered. This conclusion, we submit, is not weakened, but greatly fortified, by the provision of the settlement agreement—upon which taxpayers heavily rely—that the extended coupons would continue to be payable nothwithstanding the prior maturity or redemption of the bonds themselves. For the effect of that provision

was to make certain that the interest obligations represented by the defaulted coupons—obligations which by 1952 had become fixed and unconditional—would retain that character despite the postponement of the payment date, and would not be replaced by purely contingent obligations which could be wiped out by the premature redemption of the bonds. In short, although the provision in question did modify the terms of the coupons as originally drafted prior to 1942, the practical effect of the change was to make the extended coupons which the taxpayers received in 1952 equivalent in all respects (except due date) to the defaulted coupons, embodying fixed rights, which they surrendered.

Furthermore, assuming *arguendo* that there was a taxable exchange in 1952, it still would not follow that the extended coupons were capital assets. On that assumption, the overstamped coupons attached to the new bonds would represent rights to future interest accruing during the period 1952–1962, instead of rights to interest already accrued during the period 1942–1952. In the former case, no less than the latter, the detachment and sale of the coupons would yield ordinary income, not capital gain. The coupons do not lose their character as "interest" merely because they continue to be payable even if the bonds themselves are prematurely called. Otherwise, the issuer of bonds need only make the coupons payable in all events to convert them into capital assets and to transform the periodic interest payments

into return of capital. See *Langston, supra; McDonald* v. *Commissioner,* 217 F. 2d 475 (C.A. 6th).

Respectfully submitted.

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